

During the year prior to the Filing, Grace experienced several adverse developments in its asbestos-related litigation, including: a significant increase in bodily injury claims; higher than expected costs to resolve certain property damage and bodily injury claims; and defense costs related to new class-action lawsuits alleging damages from a former attic insulation product not previously subject to property damage litigation. In addition, five co-defendant companies in asbestos bodily injury litigation petitioned for bankruptcy court protection. These developments contribute to the risk that Grace would be subject to more claims than previously projected, with higher settlement demands. (See Notes 1 and 3 to the Consolidated Financial Statements for further information concerning asbestos-related lawsuits and claims.)

The Consolidated Balance Sheet at December 31, 2002 includes total amounts due from insurance carriers of \$282.6 million pursuant to settlement agreements with insurance carriers. The recovery of amounts due from insurance carriers is dependent upon the timing, character and exposure periods of asbestos-related claims. Grace's Chapter 11 proceedings could also affect recovery timing and amounts.

Grace intends to address all of its pending and future asbestos-related claims as part of a plan of reorganization under Chapter 11. Grace will seek to have the Bankruptcy Court establish a process to assess and appropriately quantify the numerous property damage and bodily injury claims against it. Measurement of Grace's asbestos-related liabilities will be materially affected by Bankruptcy Court rulings, the outcome of litigation and negotiations among interested parties.

## ENVIRONMENTAL MATTERS

Grace is subject to loss contingencies resulting from extensive and evolving federal, state, local and foreign environmental laws and regulations. Grace has expended substantial funds to comply with such laws and regulations and expects to continue to do so in the future. The following table sets forth Grace's expenditures in the past three years for (i) the operation and maintenance of environmental facilities and the disposal of wastes with respect to continuing operations; (ii) capital expenditures for environmental control facilities relating to continuing operations; and (iii) site remediation.

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(DOLLARS IN MILLIONS)	OPERATION OF FACILITIES AND WASTE	CAPITAL EXPENDITURES	SITE REMEDIATION
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2002	\$ 36.9	\$ 5.6	\$ 13.7
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2001	31.7	3.8	26.6
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2000	26.4	4.0	42.4
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Expenditures to comply with environmental initiatives in 2003 and 2004 are estimated to be between \$35.0 and \$39.0 million for the operation of facilities and waste disposal and \$5.0 and \$10.0 million for capital expenditures. Costs incurred to remediate environmentally impaired sites have been charged against previously established reserves. At December 31, 2002, Grace's recorded liability for environmental investigative and remediation costs related to both continuing and discontinued operations totaled \$201.1 million, as compared with \$153.1 million at December 31, 2001. This estimate of environmental costs is based on funding and/or remediation agreements in place, together with Grace's best estimate of its cost for sites not subject to a formal remediation plan. Future pre-tax cash outlays for remediation costs are expected to range between \$8.0 and \$22.0 million over the next few years. This estimate does not include spending or reimbursement of remediation costs related to Grace's former vermiculite mining and processing activities in the Libby, Montana area.

From the 1920's until 1990, Grace and previous owners conducted vermiculite mining and related activities near Libby, Montana. The vermiculite ore that was mined contained varying amounts of asbestos as a contaminant, almost all of which was removed during processing. Expanded vermiculite from Libby was used in products such as fireproofing, insulation and potting soil. In November 1999, Region 8 of the U.S. Environmental Protection Agency ("EPA") began an investigation into alleged excessive levels of asbestos-related disease in the Libby population related to these former mining activities. This investigation led the EPA to undertake additional investigative activity and to carry out response actions in and around Libby. On March 30, 2001, the EPA filed a lawsuit in U.S. District Court for the District of Montana, Missoula Division (United States v. W. R. Grace & Company et al.) under the Comprehensive Environmental Response, Compensation and Liability Act for the recovery of costs allegedly incurred by the United States in response to the release or threatened release of asbestos in the Libby, Montana area relating to such former mining activities. These costs include cleaning and/or demolition of contaminated buildings, the excavation and removal of contaminated soil, health screening of Libby residents and former mine workers, and investigation and monitoring costs. In this action, the EPA also sought a declaration of Grace's liability